

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 96-0177
Indiana Corporation Income Tax
For The Tax Periods: 1990 through 1993

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ISSUES

I. **Indiana Corporation Income Tax**: Gross Income Tax

Authority: IC 6-2.1-2-1, IC 6-2.1-2-5, 45 IAC 1-1-54, *Universal Group Limited; Universal Flavors International, Inc.; Universal Flavor Corporation; Universal Flavors of Indiana, Inc.; Universal Flavors of New Jersey, Inc.; Hurty-Peck & Company; Blanke Baer/Bowey*, 642 N.E.2d. 553 (Ind.Tax 1994)

Taxpayer protests the assessment of income tax at the high rate on Mold, Tool, and Die Receipts.

II. **Indiana Corporation Income Tax**: Gross Income Tax

Authority: 45 IAC 1-1-8

Taxpayer protests the assessment of income tax on miscellaneous receipts and other unreported income.

III. **Indiana Corporation Income Tax**: Adjusted Gross Income Tax

Authority: 45 IAC 3.1-1-56

Taxpayer protests the assessment of adjusted gross income tax based on an adjustment of 10% for non-business income.

IV. **Indiana Corporation Income Tax**: Enterprise Zone

Authority: IC 6-2.1-3-32

Taxpayer protests the calculation of the enterprise zone gross income exemption utilizing an apportionment factor rather than actual receipts.

V. **Indiana Corporation Income Tax**: Penalty

Authority: IC 6-8.1-10-2.1

Taxpayer protests the negligence penalty.

STATEMENT OF FACTS

Taxpayer is a manufacturer and supplier of automotive parts to automotive manufacturers. Taxpayer is required to meet the specifications of the automotive manufacturers. In order to meet these specifications, the taxpayer purchases molds, tools, and dies, to meet the standards required by the automotive manufacturers. The automotive manufacturer reimburses taxpayer for its purchases of required molds, tools, and dies. In general, the automotive manufacturer owns these molds, tools, and dies. Taxpayer is contractually bound to use the specified molds, tools, and dies, when producing automotive parts for the automotive manufacturers.

Additional facts will be provided when necessary.

I. **Indiana Corporation Income Tax**: Gross Income Tax

DISCUSSION

The auditor reclassified taxpayer's purchases of molds, tools and dies from manufacturing to service income. The result of the reclassification is that the taxpayer is taxed on the income at the high rate of taxation for gross income tax purposes rather than at the low rate of taxation.

During the audit period, taxpayer purchased initial molds, tools, and dies required to start-up production of the side-panels for an automotive manufacturer's new vehicle. The majority of the expense that was reclassified to service income was invested into the molds themselves; the remainder of the expense was for other tooling equipment used to produce the automotive parts to the manufacturer's specifications. The automotive manufacturer reimbursed most of these costs to the taxpayer. These receipts were assessed at the high rate of tax for gross income tax purposes. IC 6-2.1-2-5 provides that the provision of services of any character (except for those taxable at the low rate pursuant to IC 6-2.1-2-4) are subject to gross income tax at the high rate.

Taxpayer asserts two arguments in protest of the tax assessed by the Department. First, the taxpayer contends that its receipts for molds, tools, and dies were received in an agency capacity and thus not subject to tax. Citing 45 IAC 1-1-54, taxpayer argues that since the automotive manufacturer "controls" its actions in purchasing the specific molds, tools and dies and since the

taxpayer has “no right, title, or interest” in the money received, that it is acting as an agent. Taxpayer also argues that it usually breaks even or has cost overruns and receives no benefit from the transactions. The reimbursement receipts received by the taxpayer are analogous to those discussed in *Universal Group Limited*; *Universal Flavors International, Inc.*; *Universal Flavor Corporation*; *Universal Flavors of Indiana, Inc.*; *Universal Flavors of New Jersey, Inc.*; *Hurty-Peck & Company*; *Blanke Baer/Bowey*, 642 N.E.2d. 553 (Ind.Tax 1994). In *Universal Group Limited*, the tax court held that an agent corporation received payments that were reimbursements for its own expenses, e.g., payment of wages to its employees who performed the centralized administrative functions. The agent corporation had a beneficial interest in the reimbursements and retained them. Thus, the payments were subject to gross income tax. A corporate agent’s receipt of income is not taxable when it receives income to which it has no right, title, or interest and it “passes through” that income to a principal or third party. Additionally, reimbursements to an agent for amounts advanced a third party qualify as exempt “pass-through” income. Reimbursements to an agent for its own expenses are not exempt. Here, there is no pass through, taxpayer is merely reimbursed for its own expenses in purchasing molds, tools, and dies necessary to its production of automotive parts. Furthermore, *Universal Group Limited* addresses taxpayer’s argument that it receives no benefit or profit from the transactions by stating the following:

Simply put, and assuming *arguendo* the arrangements created agency relationships, there was no pass through. The reimbursements to the corporations that performed the administrative tasks were reimbursements for those corporations’ own expenses, such as paying their own employees’ wages, not for monies advanced to third parties. Indeed, the entire beneficial interest in the reimbursements lies with the parties receiving the reimbursements. That these are true reimbursements without any profit to the recipient is irrelevant: “[t]he gross income tax is applicable regardless of any profit being involved.”

Since, regardless of taxpayer’s profit in the transactions, the reimbursements to taxpayer by the automotive manufacturers do not “pass through” to a third party or the principal, the receipts are not exempt pursuant to 45 IAC 1-1-54.

Secondly, taxpayer argues that if the entire income from these receipts is taxable for gross income tax purposes, then the receipts should be taxed at the low rate (.3%) rather than the high rate (1.2%). Taxpayer argues that the receipts for molds, tools, and dies are manufacturing income received through wholesale sales as described in IC 6-2.1-2-1. Citing IC 6-2.1-2-1(c)(1)(C), taxpayer argues that its receipts from automotive manufacturers are from “sales of tangible personal property to be incorporated as a material or integral part of tangible property produced by a purchaser in the business of manufacturing, assembling, constructing, refining, or processing.” In this case, the molds, tools, and dies are not incorporated as a material or integral part of the automobiles created by the purchaser (automotive manufacturer). The molds, tools, and dies are simply used in the production of automotive parts; it is the automotive parts manufactured by taxpayer that are to be incorporated as a material part of the automobile produced by a purchaser in the business of manufacturing. Thus, the taxpayer’s receipts from automotive manufacturers that reimburse it for purchases of molds, tools, and dies, is taxable at the high rate. Pursuant to IC 6-2.1-2-5, services of any character, not taxed at the low rate pursuant to IC 6-2.1-2-4, are taxed at the high rate for gross income tax.

FINDING

The taxpayer's protest is denied.

II. Indiana Corporation Income Tax: Gross Income Tax

DISCUSSION

Taxpayer protests the inclusion of miscellaneous receipts and unreported sales in the total gross income subject to tax. Taxpayer argues that sales to certain manufacturers were shipped outside Indiana; thus, these sales should not be subject to gross income tax. The taxpayer did not present invoices to prove this assertion. The auditor determined that these receipts were unreported sales subject to gross income tax. The Department finds that the miscellaneous receipts and unreported sales are subject to tax.

FINDING

The taxpayer's protest is denied.

III. Indiana Corporation Income Tax: Adjusted Gross Income Tax

DISCUSSION

The audit explanation of adjustments states that a non-business expense has been set up against the foreign income in all years of the audit period. Taxpayer protests the factor of 10% disallowance of the non-business deduction as an expense attributable to adjusted gross income. The taxpayer argues that the disallowance of 10% of the non-business deduction be reversed resulting in a deduction of 100% of the dividends which are non-business income for Indiana purposes. A taxpayer may deduct a 100%, 85% or 50% of qualifying foreign source dividend income pursuant to IC 6-3-2-12. The issue is what comprises the dividend deduction, the gross or net dividend.

The Department's historical interpretation of the statute, however, is to limit the deduction to the amount of foreign source dividends as adjusted by related expenses. This is a plausible interpretation of the statutory language because the Indiana Adjusted Gross Income Tax Act is a net income tax scheme. The Department finds that the legislature intended to allow this dividend deduction only after a reduction for expenses. Accordingly, IC 6-3-2-12 grants a deduction for qualifying dividends received from foreign source less related expenses. The Department agrees that the add-back applies only to direct expenses. The Department presumes that fifteen percent (15%) of the foreign dividend expenses are subject to add-back as direct expenses unless the taxpayer can prove otherwise.

Therefore, because the taxpayer had no record of actual figures, 15% are subject to add-back as direct expenses.

FINDING

Taxpayer's protest is denied to the extent that 15% of the foreign dividend expenses are subject to add-back as direct expenses unless the taxpayer can prove otherwise.

IV. Indiana Corporation Income Tax: Enterprise Zone

DISCUSSION

Taxpayer protests the calculation of the enterprise zone gross income exemption utilizing an apportionment factor rather than actual receipts. The auditor determined that a separate plant breakdown of gross receipts was not available. Thus, business income derived from sources within an enterprise zone could not be separated from the business income derived from source without the enterprise zone. Pursuant to IC-6-2.1-3-32 (d), "if the business income derived from sources within an enterprise zone cannot be separated from the business income derived from source the enters without the enterprise zone, then the business income derived from sources within the enterprise zone is determined by multiplying the business income derived from sources both within and without the enterprise zone by a fraction. The numerator of the fraction is the property factor plus the payroll factor plus the sales factor. The denominator of the fraction is three (3)." The auditor applied the apportionment factor pursuant to the applicable statute. Taxpayer argues that the income derived from sources within an enterprise zone can be separated from the business income derived from source without the enterprise zone. The taxpayer provides a Schedule in its protest separating the incomes and setting forth its calculation of the exemption.

FINDING

Taxpayer's protest is sustained to the extent that income derived from sources within an enterprise zone can be separated from the business income derived from source without the enterprise zone.

V. Indiana Corporation Income Tax: Penalty

DISCUSSION

Pursuant to IC 6-8.1-10-2.1, the Department shall waive the penalty imposed on taxpayer if the person shows that the deficiency was not due to willful neglect but was due to reasonable cause. A Letter Of Finding (LOF) issued in 1989 provided taxpayer with information regarding its receipts as reimbursement for purchases of molds, tools, and dies. This LOF denied taxpayer's protest on this same issue stating that the receipts were properly reclassified as service income and not manufacturing income. The Department determined in this LOF that these receipts were taxable at the high rate, taxpayer neglected to remit gross income tax at the high rate for these receipts.

FINDING

Taxpayer's protest is denied.